Marc Cohodes Grant's Fall 2017 Conference Handouts

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Check out my websites for further details:

Home Capital Group
(TSX:HCG)

HCGexposed.com

Badger Daylighting
(TSX:BAD)

TurnOutTheBadgerDaylight.com

Exchange Income Corporation
(TSX:EIF)

MaydayEifDividend.com

Turtle Creek Asset Management
(Top shareholder of HCG and BAD)

UpTurtleCreekWithoutaPaddle.com

I.

FINANCIAL POST

COUNTERPOINT: Short-seller Marc Cohodes on why Home Capital still has big problems

Marc Cohodes: We still don't have a truly accurate picture of HCG's and the mortgage industry's financial health

June 12, 2017
6:55 PM EDT

Last month, the Financial Post published articles written by, and broadcast an interview of, Terence Corcoran in which Mr. Corcoran questioned the decision by the Ontario Securities Commission ("OSC") to accuse Home Capital Group ("HCG") and some of its current and former executives with misleading shareholders. He complained that the OSC relied on public statements I made about HCG, which he claimed were "totally sensational … and erroneous," and "outrageous," and none of my statements "has been supported." He further claimed I "totally exaggerated whatever the situation is" regarding HCG.

Mr. Corcoran told the Financial Post that he did not know me. That's true, he doesn't. For the past 30 years, I have provided valuable and timely information to Canadian and United States securities regulators and criminal prosecutors about notorious companies engaged in fraudulent accounting and business practices, such as Lernout & Hauspie, Media Vision Technology, NovaStar Financial, AremiSoft, California Micro Devices, Network Associates, TakeTwo Interactive, Krispy Kreme Donuts, Boston Chicken, and others. Some executives were criminally prosecuted (e.g., Media Vision Technology executives and the founders of Lernout & Hauspie). Between 2003 and 2005, I was the first to disclose accounting manipulations at aaiPharma Inc., which led to SEC and U.S. Department of Justice actions. The Harvard Business School published a case study about my efforts in NovaStar Financial: A Short Seller's Battle.

Mr. Corcoran also doesn't know much about HCG or its statements to investors. Instead, by trying to shift the focus to those – including the OSC – who have called out HCG's management for its misconduct, Mr. Corcoran does a disservice to investors and to the Canadian taxpayers and their government, which has insured many of the mortgages originated by HCG that were obtained on false statements in the loan applications.

We still don't have a truly accurate picture of HCG's and the mortgage industry's financial health

In 2014, the management of HCG determined that about 45 mortgage brokers working for HCG had knowingly and intentionally submitted thousands of false mortgage applications to HCG that materially misrepresented the borrower's income levels. The entity holding those mortgages (HCG) depends on borrowers' monthly payments to sustain its business, though ultimately the people who foot the bill for government-insured mortgages are the taxpayers. If borrowers default, then HCG turns to the government for payment, even though HCG's own brokers caused the problem.

For anyone who watched the meltdown in the U.S. mortgage and banking industry, the HCG brokers' scheme should have set off alarm bells and immediate public disclosures. But that did not happen. Instead, HCG's management opened an "internal investigation" code-named Trillium, notified the OSFI and CMHC in a private letter, and fired two employees and 45 external brokers.

HCG failed to tell the public about what it had found. Instead, it explained why there was a drop in the new mortgages it issued (called "originations"), by claiming that things like "macroeconomics, seasonality and competitive markets" caused the reduction. Then, in July 2015, HCG issued a news release that failed to explain the significant changes HCG had been required to adopt.

Here are the subjects Mr. Corcoran should have tackled:

Why did the brokers' fraud happen?

HCG's sales and underwriting reported through the same channel in the organizational structure, which meant there were no true checks on the management of credit risk. Evidence of this can be seen in the "phantom ticking" behavior at HCG — that is, HCG's systems allowed people to check off that a borrower's income had been verified when it had not. The OSC staff looked at HCG's internal controls and found that phantom ticking was a "learned" or "systemic practice" of HCG's underwriting group. In short, HCG allowed brokers to run wild, helping complete the same kind of false applications that drove the mortgage industry in the United States into the ground 10 years ago. It is a fair inference, from the evidence, that (at best) HCG's management chose not to see what the company was doing.

Did HCG exploit the fraudulent mortgages to the detriment of investors?

Long-tenured and very senior HCG executives and directors, who knew the company the best, sold millions of dollars of stock in HCG to unsuspecting buyers while the Trillium investigation was ongoing and, according to the OSC staff never told those buyers the truth. People who bought HCG's stock before 2015 had no idea that HCG was sitting on perhaps $1.9 billion of potentially worthless assets. Anyone with even the most superficial understanding of the securities laws disclosure requirements knows that investors cannot make intelligent decisions when the company fails to disclose to them that the company's assets are materially misstated. And, in the end, the price at which HCG insiders sold stock in 2014, before disclosing Trillium, was about double the share price after management disclosed the mortgage fraud in July 2015. Ask any of those people who bought HCG stock in 2014–2016 whether they would've like to know about Trillium and the answer will be clear.

HCG also did not timely disclose that, for a number of years, it sold some of the loans it made to a company partially owned by its lead outside counsel (who later joined HCG's board of directors). If HCG was selling its assets to a friendly insider (such as its own lawyer), then investors would want to know that — because related-party transactions must be disclosed under the securities laws. Why? Because related-party transactions may reflect financial manipulations to make assets look more valuable than they really are. That's what the management of Enron did, and people went to prison for it.

Is there still a problem at HCG?

Mr. Corcoran complained that information about Trillium was old news and he was puzzled that the OSC would take action this year, when the events in question were several years old. But the OSC — like any other law-enforcement agency — investigates before it prosecutes. That's what we should expect from regulators. In any event, there is still a big problem at HCG.

First, by extending loans to unqualified buyers, HCG has exacerbated the housing bubble in Canada and, particularly, in Toronto. HCG has enabled excessive demand in the market by lending money to unqualified buyers to purchase homes, resulting in pushing otherwise qualified buyers out of the housing market and increasing home prices. That problem is very much still alive today.

Second, the HCG board is flawed, even after some members were replaced. There are six board members who were on the board during the Trillium era. According to the OSC staff, they (a) presided over the flawed underwriting review process, (b) failed to detect the $2 billion in fraudulent mortgage applications for at least two years, (c) failed to disclose to the public the problems for over a year, (d) oversaw managers who provided false information about why loan originations were weak in late 2014 and early 2015, (e) sold stock to the public knowing that Trillium had never been disclosed, (f) retained CFO Robert Morton, who the OSC staff accused of boasting about hiding Trillium deep within the disclosures to investors, (g) failed to correct Chairman Kevin Smith's statement, on April 21, 2017, that "the business is robust" when, in fact, several banks had already limited their clients' ability to invest in HCG (and Scotiabank had already suspended all sales of HCG GICs to their clients), and (h) entered into a financing agreement with Healthcare of Ontario Pension Plan without disclosing key provisions of the deal to investors — and investors only learned that the loan was "effectively a DIP (debtor in possession) loan" when HOOPP CEO Jim Keohane described it in a BNN interview.

Finally, we still don't have a truly accurate picture of HCG's and the Canadian mortgage industry's financial health. How many mortgages held by HCG or other companies that bought the loans have defaulted? How many defaulted mortgages were insured by the Canadian government and how much money will taxpayers have to spend to bail out HCG? These are critical questions for the public to consider, especially since the Financial Post published an article on May 26, 2017 in which fund managers begged Canada's Finance Minister to save HCG.

Why the attacks on me?

I am not a fund manager (hedge or otherwise); I invest only for myself and my son. I am a vocal critic of companies who misrepresent their true businesses. In over 30 years of investing, during which time I have worked with federal prosecutors and SEC lawyers many times in the United States and in Canada, I have learned that companies that attack critics personally instead of turning a light on their operations are most often the companies with a lot to hide. I have a strong track record of identifying companies with poor and misleading disclosures. Unfortunately, HCG is an example of such a company.

Marc Cohodes is an independent investor in Cotati, Calif.

II. From a former EIF pilot who felt like he was going to die on EIF's unsafe planes:

" Sorry it took so long to contact you, but I am very busy with work. What I want to say to you is actually a very sad story - I am not sure if it will give you any new information that you do not already know, but maybe more of a reinforcement of the evil you are working with. I would like to remain anonymous as I still have some shitty shares in the company that I am hoping to unload and will take quite a loss on. I also have friends who still work there - that is the one thing that kept me at Perimeter for so long. In spite of the terrible management and sketchy working conditions - they have some amazing people working for them - most of them are trying to leave, but some can't due to family obligations.

As you may or may not know - the aviation industry is unlike any other industry in the world. It is a constant battle of one step forward and 5 steps back - either in the form of upgrading or moving on to a larger plane BUT losing your rank - on top of massive pay cuts and working more days for the end goal of when you are now old and haggard - finally flying something massive and making a great salary. I was an enigma. I actually wanted to stay at Perimeter for my career. I was happy - I didn't care what I flew - it was quality of life I was after. We worked 16 days a month, and I was pretty much home every night which was great. I had good seniority, so I got pretty much every day or holiday I wanted off. We had travel privileges with other airlines too which was a nice perk. I noticed a change after the Wherle's left. It wasn't an instant change - more of a slow insidious decline. I should have known things were going to change for the worse when they physically walked Mark off the property. Nice huh? He invented Perimeter, and that's how he left. It all started with restructuring - we used to as pilots interact face to face with dispatchers, manifestors, and cargo managers - not anymore. They moved everyone to another building, and it was phone calls and emails galore instead of face to face conversations. It made for a very sterile environment and changed the way Perimeter operated forever. They stopped respecting the pilots and did not listen to us about safety concerns. We used to be able to inform them about hazardous weather or show them why a flight should not depart. Now it was like talking to a wall - you would operate the flight at all costs - the mentality was that pilots were always trying to get out of flights - so send it. This is fine if you have the fuel to do so - if Island Lake is fogged in - sure I'll go and waste your money on fuel - but I'm coming right back when we miss. This is not unsafe - we follow rules and minimums - we were never told to break those - it is just a stupid practice instead of waiting for the weather to clear. The problems I had were when they wanted to send you with poor runway conditions. That is definitely a hazard. It is very hard to determine the state of a runway if you have no report and are relying on what you see going 150 miles an hour towards it. I remember landing in Red Sucker Lake one day and it was by far the worst conditions I had ever seen. It wasn't a runway - it was a mud pit. I got the airport manager to physically drive me up and down the whole length of the runway so I could take pictures and video of the conditions. I ended up bumping passengers so I could restrict my takeoff weight so I could leave. When I was on my way back to Winnipeg - I asked who was doing the next Red Sucker flight - and I was informed that it was going to be me. I told them I would not be returning as the Runway was in terrible condition. I was promptly met on the ground by the ops manager and was told I WOULD be going back and that I could damage the plane and Perimeter would pay for it - even though he saw the pictures and video I took and agreed it was terrible - but didn't think it was a safety issue. What the FUCK??? I refused - it is my decision as a captain for the safety of the flight - I'm pretty sure damaging the plane is a safety issue. I didn't really care what they did to me - I was not going back. They went and asked other captains to do the same thing - even threatened one telling him if he wasn't going to do it - there were others out there who would - nothing like threatening your job to get you in the air!

I wish this was an isolated incident - it was not.

Perimeter decided to expand charter work into the Arctic even though we had very little experience operating there. Perimeter used to have Dash 8's with APUs - but took them out to save on weight. An APU is crucial to operate in temperatures in the minus 50's - it warms the plane, gives you an extra generator to start the aircraft instead of on batteries - but no. Pilots operating up there in the high Arctic could not even fathom it. It was embarrassing - you had to shut down the aircraft at every stop and kill the batteries and power - leaving the plane dark to refuel if there was no working GPU. Ridiculous. The training for the Arctic - I kid you not was a youtube video on how to use an astro compass, and keewatins arctic survival video on how to build an igloo. What they don't cover is how if you pass a certain latitude - your screens basically shut off if you don't switch the FMS into True track mode. I was told this in passing by the chief pilot how him and another pilot figured it out. I did not feel safe or prepared at all to complete these charters - so I asked to be paired up with another captain who had done this particular charter before. I was told no - they didn't have enough pilots to do so - but I refused until they finally agreed. I didn't think it was too much to ask - considering it was a $100,000 charter.

There are endless stories from so many people about having to fight for your safety. I was done. I see a major accident in their near future unfortunately. Perimeter now has very inexperienced people flying their aircraft as well as outside hires. You fly maxed out all of the time - I used to fly the maximum 100.0 hours a month - legally all they can work you for. All it takes is for someone to be pressured enough to go and not stick up for what they know is right. It is a challenging environment to operate in in itself without all the management pressure on top if it.

The final straw for me was after we were shut down by transport Canada - it may have been about two weeks since they were operating back to normal - my crew had finished our pre flight checks and were waiting in the pilot lounge till we had freight at our plane. I got a phone call saying there was smoke in the cabin of my plane. I grabbed maintenance, and ran out to the plane. It ended up being a cabin light that was arcing. They maintenance guy had the nerve to ask me if I " just wanted to go " or if I wanted to MEL it - obviously I want to MEL it - we were just shut down for shit like this a few days ago! I couldn't believe it. As soon as we were walking down the stairs - I kid you not - two transport inspectors on a surprise inspection walked right on to our smokey plane. I turned to the maintenance guy and told him - good thing we are MEL-ing it huh? They have not learned their lesson at all. The plane was down for the rest of the day. We are supposed to do dent mapping of any small dents on the aircraft - I was told my another maintenance guy that it was a " bit overkill, and to use my judgement" wink wink. Its how it is - not even the huge shut down was a wake up call for them. It will NEVER change - all they care about is money. They have used fake parts on the Dash 8 after all and got caught. I literally saw the writing on the wall and got out as soon as I could. Now I work more days and am away from home all the time. I took a pay cut too - but it was all worth it to feel safe again. It sucks - it's not what I ever wanted. I am mad - I never wanted to leave - but they forced me - I felt like I was going to die there. They need to be held accountable for their lies and actions. I hope competition comes in and the government can finally shut them down for good once there is an acceptable number of flights to service the north elsewhere. It's not just Perimeter - the other fund companies all have similar problems. Good luck and godspeed. ”

III. Another former EIF pilot says EIF's tone at the top is to blame for unsafe planes:

" On behalf of myself and literally dozens of former pilots of the EIF companies, THANK YOU for shedding the light on these shifty eyed, unscrupulous individuals. You have perfectly summarized the absolute shit storm that has been brewing there over the past few years!!!!

The aviation companies of EIF were all MUCH safer before Mike Pyle and friends got their claws into them. The greedy, inexperienced, yes-men executives have driven away the majority of the experienced air crews, as well as the senior maintenance engineers, with the constant push to cut corners, and in turn made their margin of safety even smaller in the process.

As a side note, Perimeter specifically has recently been trying to turn a company that has always been culturally sensitive and respectful to it's aboriginal clientele, into something more "white" to appeal to its investors. The passengers themselves would much rather have safe airplanes and sound judgement calls being made versus a slightly fancier passenger lounge and glossy pamphlets in the airplane that are laughable (fake statistics for on time performance, so called healthy food offerings that don't exist, and other skewed "facts").

The company now refuses to listen to seasoned pilots regarding the likelihood of landing in the north in poor weather such as snow storms. Where they used to take the advice of their highly skilled crew members and cancel flights during extremely poor weather, now upper management insists that all the flights "try" on the very rare chance they will land. This usually results in passengers not landing and being flown around northern Manitoba for a day or more before making it home. Sure the company isn't cancelling as many flights but this is bush flying- cancellations are often a smart business decision when it's evident that sending a flight that can't land won't make any money. These misguided choices that look good on paper are actually killing profits so in turn they have to find other places to make up the losses.

Keep up the good work. I'm sure you'll have some photos sent in that will make you shudder. "

WIFFEN LITIGATION

Mark Wiffen
Email: mark.wiffen@wiffenlaw.ca
File No: 10151

Via Regular Mail

August 14, 2017

Exchange Income Corporation
1067 Sherwin Road
Winnipeg, MB R3H 0T8

Attention: Gary Filmon, Michael Pyle, Duncan Jessiman, Gary Buckley, Serena Kraayeveld, Donald Steuber, Edward Warkentin, Brad Bennett and Allan Davis

Dear Board of Directors,

Re: Exchange Income Fund Dividends

I write on behalf of certain interested parties regarding the operation of Exchange Income Fund ("EIF"), and in particular, its practices regarding the payment of dividends. In short, as discussed below, my clients have determined that the ongoing payment of dividends by EIF appears to be contrary to the provisions of the Canada Business Corporations Act (the "CBCA").

As you may be aware, the CBCA contains provisions intended to prevent payment of dividends which endanger its corporate capital and solvency. In particular, s. 42(b) of the CBCA provides that:

> 42. A corporation shall not declare or pay a dividend if there are reasonable grounds to believe that … (b) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities and stated capital of all classes.

My clients, having reviewed the available financial information regarding EIF, believe that EIF is not currently in a position to declare or pay dividends without contravening this provision. In other words, EIF's realizable asset value is less than its liabilities plus stated capital. My clients' calculations in reaching this conclusion are set out below.

Liabilities of EIF

EIF's second quarter balance sheet shows "liabilities" totaling $969 million CDN. EIF also has reported share capital (i.e. "stated capital" in EIF's financial statements) totaling $556 million CDN. Combined with its reported $11 million CDN in convertible equity, EIF's share capital totals $568 million CDN.

EIF's "aggregate of its liabilities and stated capital of all classes", as set out in s. 42 of the CBCA, therefore totals $1,536 million CDN.

Realizable Asset Value

In order to declare or pay a dividend, EIF must therefore have in excess of $1,536 million CDN in realizable asset value. Although the term "realizable value" is not defined in the CBCA, it has been held by the courts to refer to the "price a willing and knowledgeable vendor and purchaser, neither acting under compulsion, would agree to", rather than to a question of what is reflected on the corporation's balance sheet.[1]

My clients have reviewed EIF's public records regarding its asset ownership, as well as various public and private databases which track both airplane ownership and aircraft parts and sales. My clients have also consulted with professional aircraft parts appraisers who specialize in the CRJ, ATR and Dash models either owned by Regional One or operated by EIC legacy airlines (or both).

The result of my clients' analysis is that the realizable aircraft assets value of EIF is $419 million CDN (see Schedule "A", attached).

With respect to non-aircraft assets, my clients have made an assumption, for the purpose of this analysis, that the realizable asset value equals EIF's reported book value. Given that realizable asset value is typically less than fair market value (often far less), this is a generous assumption. My clients' calculations also assume that the substantial intangible asset and goodwill values on EIF's books are accurate, notwithstanding the recent loss of First Nations contracts, and the increase in competition in EIF's markets.

Even with these generous assumptions, the non-aircraft assets of EIF is $895 million CDN. The total realizable asset value of EIF is therefore $1,314 million CDN, even with the generous assumption set out above.

Inability to Declare or Pay Dividends

The net result of the above analysis is that even with generous assumptions, the liabilities of EIF ($1,536 million CDN) appear to substantially exceed the realizable value of EIF's assets ($1,314 million CDN). My clients' analysis in this regard is set out in more detail in Schedule "A".

To the extent that my clients' analysis is correct, s. 42 of the CBCA prohibits the declaration or payment of dividends by EIF. I note, as well, that s. 118(2)(c) of the

[1] *Clarke v. Technical Marketing Associates Ltd. Estate* (1992), 8 O.R. (3d) 734 at para 33

CBCA potentially makes directors who authorize payment of a dividend contrary to s. 42 personally liable to pay those amounts back to the corporation.

My clients believe that the continuing payment of dividends is a matter that ought to be seriously reviewed by the Board of Directors of EIF, in order to determine whether EIF is legally permitted to do so in current circumstances.

Yours truly,

WIFFEN LITIGATION PROFESSIONAL CORPORATION

Mark Wiffen

SCHEDULE "A"

All figures as of June 30, 2017 unless otherwise noted	Value ($CAD)	# Planes
Step 1: Market value of aircraft assets		
Airlines		
Calm Air	44	18
Bearskin	13	16
PAL	59	21
Perimeter	43	31
Keewatin	13	12
Total Airlines	172	98
Regional One	247	45
Total market value of aircraft assets	**419**	
Step 2: Reconcile aircraft book value to market value		
Book value of total capital assets	778	
Less: non-aircraft capital assets - Dec. 2016	(141)	
Book value of aircraft assets	637	
Less: market value of aircraft assets (from Step 1)	(419)	
Aricraft book value in excess of market value	**217**	
Step3: Total EIF asset mark to market		
Book value of total assets	1,532	
Less: mark-to-market of aircraft assets (from Step 2)	(217)	
Net realizable asset value	**1,314**	
Step 4: Statutory capital impairment test - CBCA 42(b)		
Net realizable asset value (from Step 3)	1,314	
Less: EIF liabilities	(969)	
Less: EIF stated capital = Share Capital + Equity Component of converts	(568)	
Amount EIF is below dividend payment threshold	**(222)**	

V. EIF/R1 accounting scheme

EIF's PP&E is >$350m overvalued vs. independent airplane broker valuations.
A forensic accountant explains how EIF likely manipulates its accounting, and former maintenance engineers confirm EIF management instructed them to carry it out.

1. EIF former maintenance engineers say:

"About the engines, **they used to tell us to replace high time engines with low time engines before the end of a quarter to make the appearance of a higher overall value for the aircraft. Once the next quarter started we would swap the engines back.** It took a total of a week for this process, and happened frequently. Sometimes it was a loaner engine with low time instead of one of our own engines.

Hope that explains it a bit better. …

Not exactly sure. **We were only told it was "for the books"**. I don't know what happened to these engines after they were removed or how this could be used to show value or profits. It wasn't really our area of knowledge unfortunately."

2. Independently upon review of EIF's accounting, a forensic account says:

    a. Is Regional One using an internal component exchange system as accounting tool?

In EIF's 2016 Annual Information Form it is mentioned that Regional is running a component exchange system with its external customers:

Component Exchanges

> Regional One offers flexible exchange transactions for aircraft (including flat rate exchanges and exchanges plus cost of repairs). Regional One also provides exchange pool services for various regional aircraft types and works extensively with its partners to provide advance exchange services for power-by-the-hour and fixed cost maintenance type programs. In an exchange transaction, Regional One will facilitate a transaction by providing an overhauled or serviceable component and take possession of its "as removed" part on exchange, which is refurbished to be used for another use in the future.

This mechanism better accommodates the two way traffic of inventory to capital assets, and capital assets to inventory, by virtue of its component exchange mechanism. It is also simpler and neater, and has the potential of either persuading or fooling the auditor. If a worn out component with low or zero depreciated value is swapped for a valuable fully serviced component from either Regional One's inventory or from the operational fleet's capital assets, this could give the affect of assets transfers at net zero sum valuation when the swapping of components are at equal "deemed" book value, even if their fair market values may differ. Since these internal transfer transactions take place all within the same division, they are not inter-segment sales even though they are transactions between two very different and distinct business operations; in this respect, it may be possible to not record these transfers at fair market values, and instead simply match the components at deemed equal book values, or zero values.

Even if this is technically legitimate, the market could see this as exploitation of an accounting loophole rather than a legitimate method (Enron and Valeant used "technically legitimate" methods but they were still frauds), because in effect the company is giving itself a free lunch but ultimately the cost has to be paid somewhere. Somewhere in the system there may be worthless worn out parts, and to make the books balance, there may be an over-valuation of other aircraft parts to compensate for this.

The mechanism is not perfect but there will always be loose ends. For example, it is hard to see how this component exchange method could work if a whole aircraft is taken out of service from the operational fleet and transferred to Regional One's knackers yard for inventory spare parts; how can Regional One match a component exchange by returning a whole aircraft back to the operational fleet's capital assets? Although whole aircraft asset transfer does make a nice simple component swap en bloc.

Nevertheless, the following scenario using the component exchange method is quite compelling when tied together with the data:

b. Illustrative scenario:

<u>A high value recently overhauled engine in capital assets is component swapped for a low value worn out engine in inventory</u>, but the books record the internal transfer of both engines at equal value, giving a net zero sum value affect, and consequently there is no disclosed identifiable "net" change in either capital asset or inventory valuations to reflect the internal transfer/component swap. If this was accounted for accurately, the low value worn out engine would be reflected in capital assets by lowering the equivalent average remaining useful life of aircraft engines over periods (ie from 2013 to 2016), but the data does not show this because the book value of the worn engine is recorded at an artificially higher value, as if it has been recently serviced.

The worn out engine in capital assets cannot be used and it is an idle asset, as is the aircraft frame that lost its recently overhauled engine. **Capital assets are now overvalued**. The inflated worn out engine needs to be overhauled but the cost of the overhaul would lead to an excessive engine asset value since its value already incorporates an overhaul. To compensate for this and to make the books balance, the cost of the subsequent engine overhaul is re-directed to the book value of other capital assets, such as aircraft frames. **It is likely that aircraft frames are much harder to independently value on a comparative fair and open market value basis compared to aircraft engines (which are commonly traded), therefore it is easier to shunt and disguise over -valuation in aircraft frames vs aircraft engines. The affect is aircraft frames may become over-valued and have an equivalent extended book value life.** The data in the above table does show aircraft frames appear to be under depreciated with a growing life span and may be over-valued.

Moreover, inventory now contains a high value engine booked in at an artificially low cost, hence the eventual sale of this engine produces high profit margins.

The auditor is an accountant, not an aircraft engineer or an aircraft parts valuation specialist, hence when conducting inventory and capital assets checks has no clear idea about what value to assign to an aircraft frame. It is a mystery who the auditor uses as a asset value verification specialist, and we hope he does not use the company's own internal values, who are not exactly independent.

As with many accounting schemes, over time the error resulting from egregious/fake/over-inflated numbers begins to build up and cover ups are harder to balance in the books and hide form the auditor. For example, when there is fake revenue/profits, there is a simultaneous build-up of fake cash that becomes easier for the auditor to detect as the amount grows, hence fake or over- inflated capex can be used to remove this build-up of fake cash from the books that resulted from fake revenue/profits. In the same vein, **fake/over-inflated asset values can be taken off the books via disposals, and a symptom of this may be evidence that the disposed asset value is over-inflated. The data from the company does show this, with disposed aircraft frames (yes aircraft frames again) appearing to show only a 25% depreciated value in comparison to much higher depreciated values for other aircraft assets and much higher depreciated book value of aircraft frames that remain on the books. Moreover, if asset book values are inflated, it is much harder to make a "book" profit on disposal, consequently there is minimal "gain on disposal" - the data also shows this.**

c. Need to implement IFRS 8

A big contributor to the company getting away with this may be its ability to merge its spare parts, leasing, and operating fleets businesses all in to one single reporting segment. This Does not follow accounting standards (IFRS 8 - Operating Segments) and is an area where the company has little defense.

Reportable segments

IFRS 8 requires an entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria: [IFRS 8.13]

- its reported revenue, from both external customers and intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments, or
- the absolute measure of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss, or
- its assets are 10 per cent or more of the combined assets of all operating segments.

Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principles of the the standard, the segments have similar economic characteristics and are similar in various prescribed respects. [IFRS 8.12]

If the total external revenue reported by operating segments constitutes less than 75 per cent of the entity's revenue, additional operating segments must be identified as reportable segments (even if they do not meet the quantitative thresholds set out above) until at least 75 per cent of the entity's revenue is included in reportable segments. [IFRS 8.15]

In Q2 2017 Regional One revenues represented 29% of total revenues and 43% of total EBITDA, so it should clearly deserve its own separate segmented result. Also a case could be made to give separate and individual segmented results for the parts and leasing business as they are both substantive and also very different types of businesses from one another.

The importance of forcing IFRS 8 on this company is not just to highlight and question the credibility of its accounting policy. Separating out reporting segments makes it harder for the company to disguise inter-segment transfers (it will need to disclose these) if it has managed to do this with an apparent legitimate method.

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Calgary, Alberta T2P-3M3

Mr. David Calnan, LL.B
Corporate Director
1000, 635 – 8th Avenue SW
Calgary, Alberta T2P-3M3

Mr. Paul J. Vanderberg
President & Chief Executive Officer
1000, 635 – 8th Avenue SW
Calgary, Alberta T2P-3M3

Mr. Garry P. Mihaichuk
Corporate Director
1000, 635 – 8th Avenue SW
Calgary, Alberta T2P-3M3

Deloitte LLP
Calgary, Alberta
Suite 700 850-2nd Street SW
Calgary, Alberta T2P 0R8

Mr. Grant Billing, CA
Corporate Director
1000, 635 – 8th Avenue SW
Calgary, Alberta T2P-3M3

Gerald D. Schiefelbein
Chief Financial Officer
1000, 635 – 8th Avenue SW
Calgary, Alberta T2P-3M3

Mr. William J. (Bill) Lingard, P. Eng.
Corporate Director
1000, 635 – 8th Avenue SW
Calgary, Alberta T2P-3M3

Re: Badger Daylighting Ltd.

Dear Ladies and Gentlemen:

We write on behalf of our client, Marc Cohodes, who has analyzed the business and financial results of Badger Daylighting Ltd. ("Badger") over the past year. As a result of his analysis, Mr. Cohodes has taken a short position in Badger's stock because he firmly believes that the share price does not reflect the true value of those shares and is instead inflated. We provide summary information below and urge you to examine the books and records of the company more closely. Mr. Cohodes is willing to discuss the issues he sees with you directly.

Mr. Cohodes was told that, in about April 2014, Badger managers raised $75 million in capital from about 15 individuals that was not reflected on Badger's books. The money is due to be repaid in 2019, with interest at 15%, payable monthly through Badger's payable accounts to "ghost" companies. Greg Kelly, the CFO at the time of the off-book investment, resigned from the company in May 2014, along with others in his department. Those people have personal knowledge of the off-book capital investment.

Mr. Cohodes recently analyzed the publicly available financial statements of Badger to determine whether he could confirm or deny the information he received. He determined that the information about an off-book capital investment that is being repaid appears to be true, and he also found it impossible to correlate total expenses with direct costs.

In sum, for fiscal years 2010 and 2011, Badger's total expenses by nature almost match the direct costs from the income statements for their respective years. Beginning in 2012, however, there is a difference between the two numbers and that difference has grown in each year since 2012. For fiscal year 2016, there is an unexplained difference of $26.5 million between the reported expenses by nature and the direct costs from the income statement. That differential may well be the interest expense paid to the off-book investors. Management reported the $26.5 million as operating costs, which is improper if the money was instead an interest expense. (The $26.5 million in unexplained costs represents over 56% of net income for 2016 and thus is a material amount.)

Mr. Cohodes is concerned that Gerald D. Schiefelbein, the new Chief Financial Officer, is not an accountant and thus may be unfamiliar with the details of the financial statements, even though he has an impressive background in finance and management.

We have included Mr. Cohodes's analysis referred to above with this letter, and we also refer you to http://turnoutthebadgerdaylight.com, which contains additional information from Mr. Cohodes.

Very truly yours,

David W. Shapiro

- **The cumulative unexplained difference between the Total Expenses by Nature (Note 17 FY 2016 Annual Report, Direct Costs and G&A) and the Direct Costs from the Income Statement since 2012 is over $80mm.**
    - **Where and to whom has this money gone? It doesn't appear as it fits any of the four categories in the Expenses by Nature footnote.**
    - There are significant unexplained differences between the Total Expenses by Nature (Note 17, Direct Costs and G&A) and the Direct Costs from the Income Statement beginning in FY 2012
- **FY 2010 and FY2011 Total Expenses by Nature almost match to the Direct Costs from the Income Statement for their respective years, or they are within a reasonable margin of error.**
- **The unexplained difference between the Total Expenses by Nature and Direct Costs from the Income Statement begins in 2012 and has grown every year.**
- **For FY 2016 there is an unexplained difference of $26.5mm between the Total Expenses by Nature (Note 17, Direct Costs and G&A) and the Direct Costs from the Income Statement?**

- **What makes up this unexplained difference between the Total Direct Costs and G&A and the Direct Costs from the Income Statement?**
    - It's not SG&A, that is found lower in a separate line item on the Income Statement
        - Notice in 2010 and 2011 Direct Costs matched almost perfectly to the total Expenses by Nature.
    - It's not Depreciation, that is found lower in a separate line item on the Income Statement
        - Depreciation has never been included in Direct costs or General and Administrative
    - It can't be currency because that would run through AOCI (see below Note N).
        - Both the Direct Costs and the breakdown of Direct Costs (BAD calls it "Expenses by nature.") are translated from USD and shown in CAD so they should match up.
- **The hidden expense could be Interest Expense from Off Balance Sheet debt.**
    - But why would a company report higher expenses rather than lower?
        - They need to make the cash balance reported on the Balance Sheet at the end of the year to match with their bank account statement otherwise the Auditors would become suspicious.
        - **They can hide off balance sheet debt**
        - **They can maintain compliance with Debt Covenants**
        - They can hide interest expense due to off balance sheet debt

        - If they had to put this debt on balance sheet they would likely be in violation of the Debt/EBITDA covenant of 2.75x
    - By hiding the interest expense in operating costs, they will not violate their EBITDA to Interest coverage ratio of 3x

- **These unexplained differences are material.**
    - In 2016 the after-tax impact of the unexplained costs amounts to 56.1% of Net Income
    - In 2015 the after-tax impact of the unexplained costs amounts to 62.7% of Net Income
    - In 2014 the after-tax impact of the unexplained costs amounts to 27.7% of Net Income
    - In 2013 the after-tax impact of the unexplained costs amounts to 7.7% of Net Income
    - In 2012 the after-tax impact of the unexplained costs amounts to 9.6% of Net Income
- **These unexplained differences are material.**
    - In 2016 these Unexplained Costs were 6.5% of revenue
    - In 2015 these Unexplained Costs were 6.4% of revenue
    - In 2014 these Unexplained Costs were 4.8% of revenue

(Expressed in thousands of Canadian Dollars unless stated otherwise)

17 Expenses by nature

Direct costs and general and administrative expenses include the following major expenses by nature:

	2016	**2015**
Wages, salaries and benefits	177,096	163,907
Fees paid to operating partners	35,812	49,104
Repairs and maintenance	26,311	24,970
Fuel	18,618	19,273

Employees	605	881	1112	1419	1655	1554	1605
Direct Costs and G&A	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Wages, salaries and benefits	$42,267.41	$65,935.47	$90,634.00	$124,854.00	$153,483.00	$163,907.00	$177,096.00
Fees paid to operating partners	$38,728.77	$43,729.65	$42,441.00	$50,141.00	$66,524.00	$49,104.00	$35,812.00
Fuel	$3,838.36	$8,408.12	$11,956.00	$17,311.00	$25,832.00	$19,273.00	$26,311.00
Repairs and Maintenance	$7,804.30	$11,358.31	$14,617.00	$17,973.00	$24,365.00	$24,970.00	$18,618.00
Total	**$92,638.83**	**$129,431.55**	**$159,648.00**	**$210,279.00**	**$270,204.00**	**$257,254.00**	**$257,837.00**
Direct Costs from Income Statement	$92,403.64	$129,398.62	$163,673.00	$214,711.00	$290,547.00	$283,105.00	$284,297.00
Unexplained Difference	**$235.19**	**$32.93**	**($4,025.00)**	**($4,432.00)**	**($20,343.00)**	**($25,851.00)**	**($26,460.00)**
General and Administrative Expense from Income Statement	$12,571.52	$11,974.12	$11,741.00	$15,714.00	$11,551.00	$13,756.00	$15,142.00
Direct Costs from Income Statement	$92,403.64	$129,398.62	$163,673.00	$214,711.00	$290,547.00	$283,105.00	$284,297.00
General and Administrative Expense from Income Statement	$12,571.52	$11,974.12	$11,741.00	$15,714.00	$11,551.00	$13,756.00	$15,142.00
Total Costs	$104,975.16	$141,372.74	$175,414.00	$230,425.00	$302,098.00	$296,861.00	$299,439.00
Wages, salaries, and benefits per Average Employee	$69.86	$88.74	$90.95	$98.66	$99.86	$102.15	$112.12
Wages, salaries, and benefits per Ending Employee	$69.86	$74.84	$81.51	$87.99	$92.74	$105.47	$110.34

N) Foreign currency translation

Items included in the financial statements of each consolidated entity are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities not denominated in the functional currency of an entity are recognized in the consolidated statement of comprehensive income.

Assets and liabilities of entities with functional currencies other than Canadian dollars are translated at the period end rates of exchange, and the results of their operations are translated at average rates of exchange for the period. The resulting translation adjustments are included in the accumulated other comprehensive income when settlement of which is neither planned nor likely to occur in the foreseeable future.

When settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely to occur in the foreseeable future, foreign exchange gain or losses related to such items are recognized in other comprehensive income, and presented in accumulated other comprehensive income in equity.

- **These unexplained differences are material.**
  - In 2016 the after-tax impact of the unexplained costs amounts to 56.1% of Net Income
  - In 2015 the after-tax impact of the unexplained costs amounts to 62.7% of Net Income
  - In 2014 the after-tax impact of the unexplained costs amounts to 27.7% of Net Income
  - In 2013 the after-tax impact of the unexplained costs amounts to 7.7% of Net Income
  - In 2012 the after-tax impact of the unexplained costs amounts to 9.6% of Net Income
- **These unexplained differences are material.**
  - In 2016 these Unexplained Costs were 6.5% of revenue
  - In 2015 these Unexplained Costs were 6.4% of revenue
  - In 2014 these Unexplained Costs were 4.8% of revenue

BAD	2010	2011	2012	2013	2014	2015	2016
After tax Impact of Unexplained Costs % of Net Income	**0.0%**	**-0.1%**	**9.6%**	**7.7%**	**27.7%**	**62.7%**	**56.1%**
Unexplained costs % of Revenue	**0.0%**	**0.0%**	**1.7%**	**1.4%**	**4.8%**	**6.4%**	**6.5%**

- Badger reclassifies some General and Administrative expenses to Direct Costs but the Expenses by Nature remain the same.

Reclassification
Beginning in the first quarter of 2015, general and administrative expenses include only those costs related to the Corporation's three main administrative centers – the Corporate office in Calgary, the Canadian administration center in Red Deer, Alberta and the United States administration center in Brownsburg, Indiana. Costs that are incurred outside these centers have been classified as direct costs. In 2014, $7,901 in general and administrative expenses have been reclassified as direct costs. This reclassification did not impact net earnings, earnings per share, financial position or cash flows.

The above disclosure says that for the FY 2014 $7,901 was moved from General and Administrative and reclassified as Direct Costs. However, when we look at the 2015 annual report and the breakdown of Direct costs and general and administrative expenses (Expenses by nature), we don't see an increase in the 2014 numbers as they were originally reported in 2014.

18 Expenses by nature

Direct costs and general and administrative expenses include the following major expenses by nature

	2015	2014
Wages, salaries and benefits	163,907	153,483
Fees paid to operating partners	49,104	66,524
Fuel	19,273	25,832
Repairs and maintenance	24,970	24,365

19 Expenses by nature

Direct costs and selling, general and administrative expenses include the following major expenses by nature:

	2014	2013
	$	$
Wages, salaries and benefits	153,483	124,854
Fees paid to operating partners	66,524	50,141
Fuel	25,832	17,311
Repairs and maintenance	24,365	17,973

- **However, you do see the $7,902 moved in the consolidated income statement as show below. Why is this $7,902 not included in the Expenses by nature if Badger specifically said they were direct costs?**

BADGER DAYLIGHTING LTD.
Consolidated Statement of Comprehensive Income
(Expressed in thousands of Canadian Dollars)

For the year ended December 31	Notes	2015	2014
Revenues	17	404,620	422,219
Direct costs	2, 18	283,105	290,547
Gross profit		121,515	131,672
Depreciation of property, plant and equipment	7	42,366	33,611
Amortization of intangible assets	8	1,276	1,276
Impairment of Fieldtek oil tank cleaning assets	8	6,508	-
General and administrative	2, 18	13,756	11,551
Share-based compensation expense	16	1,710	2,393
Operating profit		55,899	82,841

BADGER DAYLIGHTING LTD.

Consolidated Statement of Comprehensive Income

(Expressed in thousands of Canadian Dollars)

For the year ended December 31	Notes	2014 $	2013 $
Revenues	18	422,219	324,594
Direct costs	19	282,645	214,711
Gross profit		139,574	109,883
Depreciation of property, plant and equipment	10	33,611	24,183
Amortization of intangible assets	11	1,276	213
Selling, general and administrative	19	19,453	15,714
Deferred unit plan	17	2,393	10,010
Operating profit		82,841	59,763

- **Why does Badger, in the 2015 Annual Report with Audited Financial Statements, list 2014 Direct Costs in the Income Statement as $290,547 but in the Segment Reporting section (Note 20) Badger lists Direct Costs as $291,432?**
  - Both of these values differ from the Expenses by Nature breakdown of costs which totals to $270,204.
  - Which of these three numbers is the correct number?

20 Segment reporting

The Corporation operates in two geographic/reportable segments providing non-destructive excavating services in each of these segments. The following is selected information for the years ended December 31, 2015 and 2014 based on these geographic segments.

For the year ended:	December 31, 2015			December 31, 2014		
	Canada	U.S.	Total	Canada	U.S.	Total
Revenues	153,849	250,771	404,620	215,707	206,512	422,219
Direct costs	113,484	169,621	283,105	149,280	142,152	291,432
Depreciation of property, plant and equipment	15,288	27,078	42,366	14,663	18,948	33,611
Amortization of intangible assets	1,276	-	1,276	1,276	-	1,276
Impairment related to oil tank cleaning assets	6,508	-	6,508	-	-	-
General and administrative	5,861	7,895	13,756	6,117	4,548	10,666
Profit before tax	4,824	36,419	41,243	32,866	40,653	73,519

BADGER DAYLIGHTING LTD.
Consolidated Statement of Comprehensive Income
(Expressed in thousands of Canadian Dollars)

For the year ended December 31	Notes	2015	2014
Revenues	17	404,620	422,219
Direct costs	2, 18	283,105	290,547
Gross profit		121,515	131,672

- **The hidden expense could be Interest Expense from Off Balance Sheet debt.**
  - But why would a company report higher expenses rather than lower?
    - They need to make the cash balance reported on the Balance Sheet at the end of the year to match with their bank account statement otherwise the Auditors would become suspicious.
    - **They can hide off balance sheet debt**
    - **They can maintain compliance with on balance sheet Debt Covenants**
    - They can hide interest expense due to off balance sheet debt
      - If they had to put this debt on balance sheet they would be in violation of the **Debt/EBITDA covenant of 2.75x**
    - By hiding the interest expense in operating costs, they will not violate their **EBITDA to Interest coverage ratio of 3x**
- **If the unexplained difference in Direct Costs is interest expense on off balance sheet debt, to whom is money owed and how much is owed? When is the money due? When was the money borrowed? Who approved this loan? Does the Board of Directors know about the loan?**
- **At an assumed 10% interest rate, we estimate that there is an incremental $264mm in undisclosed, off balance sheet debt.**

BAD	2010	2011	2012	2013	2014	2015	2016
EBITDA	$34,635.62	$52,805.35	$63,814.00	$94,169.00	$120,121.00	$107,759.00	$104,763.00
Interest	$749.54	$1,210.52	$5,272.00	$6,077.00	$26,149.00	$31,766.00	$31,412.00
EBITDA/Interest as reported	46.21x	43.62x	12.10x	15.50x	4.59x	3.39x	3.34x
Debt/EBITDA as reported	1.16x	0.56x	0.73x	0.87x	1.04x	0.96x	0.96x
Unexplained costs	$235.19	$32.93	($4,025.00)	($4,432.00)	($20,343.00)	($25,851.00)	($26,460.00)
Unconsolidated Debt Balance Assuming Unexplained cost is Interest	($2,351.89)	($329.33)	$40,250.00	$44,320.00	$203,430.00	$258,510.00	$264,600.00
Debt as reported	$40,671.40	$29,773.23	$46,554.45	$82,319.00	$124,358.00	$103,852.00	$100,698.00
Total Debt plus Unconsolidated Debt	$37,995.74	$29,443.90	$86,804.45	$126,639.00	$327,788.00	$362,362.00	$365,298.00
Total Debt plus Unconsolidated Debt / EBITDA	1.10x	0.56x	1.36x	1.34x	2.73x	3.36x	3.49x
EBITDA/Interest plus Unexplained Cost Difference	46.21x	42.47x	6.86x	8.96x	2.58x	1.87x	1.81x
Assumed Interest Rate on Unconsolidated Debt	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%

- **Deloitte may want to change their opinion on Badger's financial statements**

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Badger Daylighting Ltd. as at December 31, 2016, and December 31, 2015 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte LLP

Chartered Professional Accountants
March 17, 2017
Calgary, Alberta

June 14 2017

Montreal QC

Gentlemen,

After discussing with my wife, we've come to the conclusion that the lack of support over the years from Badger Corporate has had the devastating effect of us being incapable of competing in the Hydrovac business in Quebec. We have therefore made the decision to close the business at a great financial loss. This week I will be required to extend my line of credit with the bank in order to satisfy the payroll obligation. There is no reasonable prospect of being able to carry this debt with only 2 or 3 working machines. The lack of work has also impacted many of my loyal employees that have had to resign in order to seek regular work elsewhere. There has been no corporate support to sustain this business. The promises of new equipment and competitive business terms have not been fulfilled by Badger. We have tried discussing this with you for months so this cannot come as a surprise.

This situation has created a tremendous stress that has caused damaged to my health and my family is beyond description. Today I am at risk of losing everything I have and forcing my family into difficult times. I can no longer offer my employees any good faith that I can pay them on time or provide them full time employment.

I have previously been assured that Badger was preparing to purchase the territory back. I do not wish to put Badger in a difficult position so I am prepared to assist you immediately in facilitating a transaction and transfer. If Badger has decided not to do so then we need to discuss the mechanics of immediately shuttering the operation and we can dispute the situation in another forum. I will need to release my employees and provide them an employment reference. Liquidation of my assets should begin immediately and arrangements to return the Badger trucks should be discussed. If Badger wishes to find some other support or make another arrangement with me I will need to know immediately.

I would like to avoid unnecessary and lengthy litigation for my losses but understand that you may consider this a strategic business option. There is extensive interest by many into the business affairs of Badger Daylighting so I am mindful of those that may exploit this for their own purposes. Badgers current public profile has made it challenging for me to seek private financing to continue the business. We have not had full time asset utilization for quite some time and the pricing of services is priced outside the Quebec market. My equipment is almost 20 years old and there is no corporate marketing in French as required by Quebec law. In short, Badger has abandoned me and the business.

I'm sorry this has come to this but my wife and I have to find jobs to be able to keep our house and feed our kids and right now, every week is sending us deeper in the hole. I cannot go on.

Regards,

Alain Gosselin